



# SMEs and new ventures need business model sophistication



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**Abstract** Business models are a current hot topic, and their design has become a key to performance. In fact, business model design is often associated with innovation. Many firms, though, fail to realize the full potential of their current business model simply because they are not aware of it. Nevertheless, Google succeeded in realizing its business model's full potential by offering its main service, Internet search, completely for free while capturing value from secondary opportunities such as Google AdWords. Especially for new ventures and SMEs, capturing value from secondary opportunities or business model sophistication is of critical importance toward increasing the pool of resources at hand and giving momentum to the firm's development. But what are these opportunities, and where can they be found? Based on various examples including Google, Ryanair, the Super Girl Contest on Hunan TV, and Spreadshirt, this article develops a framework that introduces five business model sophistication strategies: (1) uncover additional functions of your product, (2) identify strategic benefits for third parties, (3) take advantage of economies of scope, (4) utilize cross-selling opportunities, and (5) involve users and the crowd. All five strategies place a strong emphasis on stakeholder commitment.

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## 1. Business model sophistication as a key performance driver

While there has been much discussion about innovation as a key driver of success, many firms have trouble realizing the potential of extant value-capturing opportunities. This is particularly true

for new ventures and SMEs, which are often absorbed by the business at hand and unable to look beyond pressing matters to the application of business model sophistication. By focusing solely on their main business, these firms put their bottom line at risk and incur the costs of missed opportunities. In this article, we address the problems small and medium-sized enterprises (SMEs) and new ventures face because they often do not generate or use sophisticated business models. We will show through examples how sophisticated business models can be constructed and used as strategic options. Moreover, we will offer

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five business model sophistication strategies and make recommendations for their implementation.

The story of Google exemplifies how crucial business model sophistication can be for a firm's success. It is hard to imagine, but not too long ago Google was a startup working its way into the markets. Google began to take root in the late 1990s under the invention of a superior search technology (Vise & Malseed, 2005). Based on that, the firm's first offering was an Internet search engine; it turned out to be very successful, spread worldwide, and achieved high user numbers. However, there was a problem: even though Internet searches created enormous benefits to consumers, there was no willingness to pay for it in the market. From the beginning, Google had to offer its service free of charge—a characteristic that has not changed.<sup>1</sup> Therefore, Google did not initially appear to be a promising new venture. Perhaps this is why strong incumbents such as Lycos and Yahoo! showed little interest in the newcomer.

This changed approximately 2 years later with the introduction of Google AdWords, a pay-per-click advertising service. Google's founders realized that appearing on search results lists holds tremendous value for stakeholders with a willingness to pay: firms and other players interested in being found on the Internet. None of the firm's competitors, including the aforementioned incumbents Lycos and Yahoo!, had realized this value-capturing opportunity. In contrast to the original Google business model, this sophisticated model was highly profitable.

Business model sophistication is the realization of secondary value-capturing opportunities beyond the main business. These value-capturing opportunities are secondary because they depend on the main business and are only made possible by it. Johnson (2010, p. 31) specified this type of opportunity as "the adjacent possible" and described it the following way:

The strange and beautiful truth about the adjacent possible is that its boundaries grow as you explore them. Each new combination opens up the possibility of other new combinations. Each new combination ushers new combinations into the adjacent possible.

Seen from this perspective, secondary value-capturing opportunities are an element of the firm's business model and have a direct impact on the firm's profits. Not realizing them basically equates to wasting money and losing competitive edge.

The Google example illustrates one more thing: It is often challenging for firms to uncover and realize secondary value-capturing opportunities. Even big players like Lycos and Yahoo! failed to spot the business model sophistication potential of Internet search. One reason entrepreneurs and managers miss opportunities is because they tend to focus on their main business. Christensen (1997) found that this prevents successful firms from identifying necessary business model innovations. It also prevents them from directing their efforts toward exploring secondary value-capturing opportunities. To counter this, large firms employ market researchers and run strategic units that systematically search for opportunities. However, SMEs and new ventures in particular wrestle with resource constraints and therefore depend heavily on the experience and intuition of management. Market environments are often new for business founders; as such, they tend to imitate existing industry business models or apply analogical thinking and reasoning (Enkel & Mezger, 2013). Thus, despite being less constrained by path dependencies and inertia as compared to more established firms, market entrants often do not design business models that include secondary value-capturing opportunities. For entrepreneurs, the main business focus tends to be a strategy for reducing complexity. However, focusing solely on the main business can act as a barrier to growth and expansion. Therefore, identifying secondary value-capturing opportunities is of critical importance toward increasing the pool of resources at hand and giving momentum to an SME's or new venture's development.

An example of complex business model sophistication is the 2005 Super Girl Contest in China (Wang, 2007), which realized several concurrent secondary value-capturing opportunities. The Super Girl event received a lot of attention not only because it was the first major contest of its kind in China, but also because it was one of the first occasions where a broad audience was able to participate in a public decision-making process. Local television station Hunan TV profitably hosted a platform to broadcast the event despite charging a relatively low fee from the contestants and audience. It captured additional value by including two sponsors: Mengniu, a producer of dairy products and ice cream, and Tianyu Media, a television production company specializing in talent scouting and management in the Mandarin-speaking region. Mengniu paid the overhead costs in exchange for naming rights while Tianyu Media met the planning and promotion costs in return for ownership of the Super Girl brand. Additional revenues came from advertisers and telecom companies, which cashed in on a percentage of

<sup>1</sup> It belongs to the so-called 'free' business models (see Anderson, 2009).

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